

DEPARTMENT OF CORPORATIONS

State of California • Business, Transportation and Housing Agency

Gray Davis

Governor

Demetrios A. Boutris

California Corporations Commissioner

May 7, 2002

Mr. Hardwick Simmons
Chairman and Chief Executive Officer
The Nasdaq Stock Market, Inc.
4 Times Square
New York, New York 10036

Re: Standards to Address Enron-Related Concerns

Dear Mr. Simmons:

By letter to you dated March 14, 2002, the California Department of Corporations asked The Nasdaq Stock Market, Inc. (NASDAQ) to adopt new listing standards for enhancing corporate governance and investor protection in response to the Enron debacle. You responded by sending a copy of your April 11, 2002, letter to Mr. Harvey L. Pitt, Chairman, Securities and Exchange Commission, describing corporate governance listing standards that NASDAQ is considering in response to SEC concerns.

While your responsiveness to the SEC's concerns is commendable, a copy of your letter to Mr. Pitt does not constitute a response to the specific issues raised by the Department of Corporations.

The Department's General Counsel, Timothy Le Bas, is developing regulatory responses to Enron being contemplated by the Department and he has discussed these with your General Counsel, Ed Knight. I strongly suggest that Mr. Knight continue his dialogue with Mr. Le Bas as the Department proceeds.

As you know, securities, and warrants or rights to purchase or subscribe to those securities, listed on the National Market of NASDAQ are currently exempt from qualification in California, because the Department of Corporations has certified the National Market in accordance with California Corporations Code section 25100(o). In addition, while the National Securities Markets Improvement Act of 1996 (NSMIA) restricts the regulatory authority of the Department of Corporations over certain "covered securities," NSMIA does not extend that restriction to warrants or rights to purchase or subscribe to covered securities.

As you are also aware, securities listed on the Small Cap Market of NASDAQ are subject to qualification under California law, unless they are exempt from qualification.

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In response to disparities exposed by the Enron debacle and its progeny, the Department of Corporations is considering the advisability of:

- (1) Changing certification requirements for warrants or rights to purchase or subscribe to securities listed on the National Market of NASDAQ, and
- (2) Adopting qualification requirements for securities listed on the Small Cap Market of NASDAQ.

The purpose of these actions would be to afford investors and non-executive employees in companies listed on the National Market and Small Cap Market of NASDAQ with rights and choices equal to those provided to corporate insiders.

Corporate insiders at Enron took huge risks. Yet when the company collapsed, the insiders retained their millions while non-executive employees lost their retirement and jobs and ordinary investors lost their savings. Corporate insiders had compensation plans that gave them the choice of when to bet the farm on Enron. Non-executive employees not only did not have the choice, but they were encouraged to invest even more in Enron while insiders were dumping their stock.

The lessons of Enron will only be learned if the financial services marketplace eliminates the disproportionate risk imposed on investors and ensures that both risk and choice are equally shared by corporate insiders, non-executive employees, and ordinary investors.

As Mr. Le Bas has discussed with Mr. Knight, the actions being contemplated by the Department would seek to achieve the following objectives:

- Ensuring that management and employees share an equality of risk with respect to shareholder arrangements, including employment compensation.
- Requiring timely disclosure of critical financial information in an understandable format to shareholders, including employee shareholders.
- Eliminating option and other compensation arrangements that undermine management's incentive to serve the company as a true equity owner.
- Implementing appropriate standards and mechanisms, including investor education, to help achieve diversification of employee shareholdings.
- Maintaining internal accountability controls to help guard against self-dealing and misrepresentations concerning the company's financial condition.

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I welcome your thoughts and invite you and NASDAQ into a direct dialogue with our Department about these responses to Enron.

Very truly yours,

/s/

DEMETRIOS A. BOUTRIS

California Corporations Commissioner

& Special Counsel to the Governor

cc: Mr. Richard A. Grasso
Chairman and Chief Executive Officer
New York Stock Exchange